

There's no shortage of innovation in telecoms, but finding the funds to start a new company is a bigger challenge, writes Jane Bird. However, there are investors willing to take the plunge, if you look in the right place

Appetite for risk disappears as carriers cut down buying

When Sequoia Capital, the California-based venture funding company, presented its views on startups and the economic downturn in October 2008, the first slide was an image of a gravestone. The inscription read: "RIP Good Times".

Though the message grabbed the attention of the audience, it didn't surprise them. Startups, if not dead in the water, are still seen as a no-go area by many investment companies. Cash strapped, they are reluctant to part with what they have, in case it is needed to help their existing portfolio through difficult times.

But there is no shortage of innovation in the telecoms sector. In fields such as smart phones and mobile internet applications, entrepreneurs and technologists are coming up with a stream of ideas for groundbreaking products and services. Has the finance vanished or is there money about for the right ideas?

Undoubtedly, there has been a huge reduction in investment for the communications and networking sector, as shown by figures from Dow Jones VentureSource. Just seven rounds were raised in Europe during the first quarter of 2009, at a value of €23.2 million, compared with 27 deals raising €139.1 million in the first quarter of 2007.

In the US, investments were down from 47 to 27 and total values from \$610.9 million to \$281.1 million in the same period.

transferred yet to venture startups; pure venture investment is dire at the moment." He sees the most activity at present in large companies such as Qualcomm Ventures, Vodafone Ventures and Intel Capital investing strategically in related businesses.

To some extent, raising funds for communications has always been difficult compared with, say, IT, says John Yeomans, director of First Capital, which helps startups find backing.

"IT can look forward to thousands or even millions of potential customers, whereas communications companies are quite often selling to a few hundred operators worldwide, making it risky if they don't buy. Also, operators are notoriously slow to adopt new things."

Substantial deals

Nevertheless, some substantial deals are taking place. In 2008, Enforta, a Moscow-based WiMax services provider, raised €33.3 million; Ubidyne, a digital radio technology specialist in Germany gained \$28.3 million; and PacketFront, a high speed broadband specialist, won backing of €26 million.

In the US, Colorado-based broadband wireless company Open Range Communications raised \$100 million in January 2009, as did Pocket Communications, a flat-rate voice and data services company located in Texas, in November 2008.

Valuations are often the sticking point, with the biggest casualties at present companies going for Series B funding — a phase currently known in the industry as the Valley of Death. At this stage, companies are still loss-making and can barely see the end of the tunnel. Commitments have been made and profitability may be a long way off.

Kaj-Erik Relander, a partner at VC firm Accel Partners, points out that some company valuations have plunged 30-40% in the past 18 months. "This can make it look as if you're doing an A round all over again."

The crucial factor is how much cash is required to break even, according to Frédéric Rombaut, head of Qualcomm Ventures Europe. "If the business is very capital-intensive and is going to need series C, D, E, F and G rounds before being profitable, it's probably not very compelling."

But given the right cash burn rate, entry and projected valuation at exit, he says Qualcomm will do B rounds.

The overriding factor for most investors is the sector: some parts of the telecoms industry simply offer much better prospects for growth.

Accel sees telecoms equipment and software as unattractive at present because of the lack of carrier buying. "That market could take a year or two, which

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Appetite for risk

The problem is only too familiar to Netronome, a network equipment chip-maker based in Cambridge, UK, currently involved in a series D fundraising. "There's no question it is tough," says CEO Niel Viljoen. "Venture funds are being asked lots of questions at present and this is having a very severe effect on even the most promising startups. We've had a string of good quarters, but we get no credit for this. The whole appetite for risk has disappeared."

The money is there, but the biggest issue is valuation, Viljoen says. "Pickup in the open market hasn't

Frédéric Rombault of Qualcomm Ventures Europe: focusing on the whole wireless value chain



doesn't suit the smaller companies which can't hold on the way larger ones can," says Relander, who was CEO of Sonera, the Finnish operator, before it merged with Telia.

Erosion of margins

Another problem is the erosion of margins by competition from China and India, he says.

But, like many investors, he is positive about mobile in general, citing Accel portfolio companies such as Playfish and Gameforge that are not currently in mobile, but could adapt their technology to the wireless environment.

Mobile search is another sector he sees as ripe for development, with few applications beyond mapping so far.

Qualcomm Ventures is focusing on the whole wireless value chain, from component through network infrastructure to mobile internet applications. With offices worldwide, it identifies trends and investment targets globally. Take investee company Streamezzo, a mobile TV application enabling company based in Paris.

"Mobile TV isn't happening in Europe yet, but in China it's growing fast," says Rombault. "Six months ago, Streamezzo had only European customers. Now 80% of its growth is from China. UK-based ip.access has established a global lead in 3G femtocells despite limited funding thanks to a superior technology and smart marketing and distribution."

Other sectors Rombault favours include network infrastructure and hardware components, while pointing out that these are tougher businesses to invest in generally because they consume more capital.

Qualcomm tends to co-invest with private equity companies and takes a stake of no more than 20%. Investee companies gain the financial skills of the private equity company alongside Qualcomm's industry knowledge and corporate guidance on issues such as timing, standards and product roadmap.

Qualcomm's investments are not made to preacquire companies. Of the 45 it has backed, it has only ever acquired one, display manufacturer Iridigm, which it funded in 2002 and bought in 2004.

Sometimes Qualcomm's relationship with investee companies develops into a partnership. This is the case with Inside Contactless, a contactless payment card technology company, which has a major market share in the US with financial services customers such as Visa.

"Now we're working in partnership to integrate its technology on to Qualcomm's platform so that when a handset manufacturer wants chips for standards-based contactless payment we've already got plug-and-play technology tested," Rombault says.

Investment opportunities

Another company hunting for investment opportunities is 2ergo, a mobile marketing company based in Manchester, UK. Keen to acquire or take a stake in technologies that could be adapted for smart phones, 2ergo has £9.6 million in the bank.

Chris Brassington, group MD, says: "We are constantly looking for potential businesses in our market to invest in or acquire. The macro-economic climate has not dampened our enthusiasm. In fact, we feel it is potentially a better time to find companies. There are more opportunities for us."

Investee companies needn't be a perfect fit with 2ergo, Brassington says. They gain a broader platform, product range, management and financial expertise, while 2ergo gets new channels and new regions.

For example, in May 2009 it acquired Wapfly Technologies, an Australian company which develops mobile applications and websites along with content management, SMS and mobile payment systems. The deal was attractive to 2ergo because it brought access to clients in Australia and a Sydney office. Wapfly also offered a relationship with incumbent carrier Telstra.

"An existing relationship between an investee company and the carrier is crucial to ensure connectivity," says Brassington. "Then we can supplement it." Wapfly also had some showcase clients including Australian public broadcaster ABC — media being one of 2ergo's key target markets.

Cultural fit

It is also essential to check that it will be possible to integrate the people and that there is a fit culturally as well as on spreadsheets, says Brassington.

Of course, in headier times flotation is often the best way entrepreneurs can realise financial reward for their hard work. The problem for them now is surviving until the climate is right, as Netronome knows. Founded in 2003 and well into revenues, it expects to be profitable within a year. But it recognises the climate for IPOs is unlikely to be recover until 2010 at the earliest.

So despite the messages of doom, there are investors out there willing to take the plunge, especially in sectors with a mobile dimension such as the internet, payment systems, gaming, social networks, location-based services, software as a service and cloud computing.

Mobile analytics also interests Accel's Relander. "Whereas established manufacturers in other sectors are able to analyse their production processes, the mobile industry has not yet developed a way to monitor how the networks or handsets are behaving," he says. "They need to introduce this sort of business process automation."

And there is currently another option for the competitively minded. Qualcomm is running a business plan competition, Qprize, which is offering \$550,000 seed funding to entrepreneurs in the US, Europe, China and India.

Time is short, with entry closing at the end of July 2009, but it could be worth a try. Enterprising young businesses should explore every avenue and not be deterred by the gloom-mongers. Investors still need to invest, they just take a bit more persuasion at the moment. ■